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INSOLVENCY REFORM ADVOCACY CAMPAIGN

FINAL REPORT

USAID GOVERNING FOR GROWTH (G4G) IN GEORGIA

10 AUGUST 2016

This publication was produced for review by the United States Agency for International Development. It was prepared by Deloitte Consulting LLP. The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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USAID GOVERNING FOR GROWTH (G4G) IN
GEORGIA

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DATA

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ACRONYMS

ALFG	Association of Law Firms of Georgia
AmCham	American Chamber of Commerce in Georgia
BAG	Business Association of Georgia
BGI	BGI Advisory Service Georgia
BLC	BLC Law Office
CACCI	Confederation of Asia Pacific Chambers of Commerce and Industry
DAS	Distributors Association of Georgia
EBRD	European Bank for Reconstruction and Development
G4G	Governing for Growth in Georgia
GCCI	Georgian Chamber of Commerce and Industry
GCF	Georgian Co-Investment Fund
GIZ	The German Federal Enterprise for International Cooperation
GoG	Government of Georgia
GSMEA	Georgian Small and Medium Enterprises Association
IOH	Insolvency Office Holder
IRAFT	Insolvency Reform Advocacy Task Force
MoESD	Ministry of Economy and Sustainable Development
MoF	Ministry of Finance
MoJ	Ministry of Justice
NBE	National Bureau of Enforcement
PPD	Public-Private Dialogue
USAID	United States Agency for International Development
VBAT	VBAT Law Firm

CONTENTS

1.	SUMMARY OF THE ACTIVITY OBJECTIVES AND ACHIEVEMENTS	1
2.	A SUMMARY OF THE ACTIVITY IMPLEMENTATION PROCESS, LESSONS LEARNED AND RECOMMENDATIONS	10
3.	DESCRIPTION OF PROJECT IMPACT AND RESULTS (BASED ON THE INDICATORS PRESENTED IN THE APPLICATION AS WELL AS ANY OTHER ANECDOTAL INFORMATION, STAKEHOLDER OR OBSERVER COMMENTARY)	14
4.	A DISCUSSION OF HOW GRANT FUNDING CONTRIBUTED TO THE OBJECTIVES OF THE PROGRAM	16
APPENDIX A:		17
APPENDIX B:		28

1. SUMMARY OF THE ACTIVITY OBJECTIVES AND ACHIEVEMENTS

The objective of the Project Insolvency Reform Advocacy Campaign was to create a formidable advocacy campaign for insolvency reform by making it a prioritized interest of the public.

To achieve this goal, the awareness raising campaign on existing shortcomings of current insolvency system and necessity of the reform, mobilization of representatives of private sector and their involvement in the public-private discussions was planned. The campaign was carried out in close cooperation with the private sector.

Overall during the implementation period, the following milestones have been accomplished:

The First Milestone: Advocacy Strategy

The purpose of the first milestone was to form the Insolvency Reform Advocacy Task Force (IRAF) and develop an advocacy strategy for Insolvency Reform in Georgia.

Workshop. For mapping the strategy and developing the action plan of the project, the project team, as well as leading practitioners in the field, Association of Legal Firms of Georgia (ALFG) members and G4G, organized a two-day workshop in Borjomi. During the workshop, the following achievements were accomplished:

1. The advocacy strategy was drafted;
2. The main stakeholders for interviews were identified;
3. The special questionnaires for conducting interviews with different groups were developed;
4. The topics for the training/conference were discussed;
5. The modules for the training/conference were drafted.

During the workshop, the conference/training slogan “When Crises Generates Opportunities” was developed.

For the upcoming conference/training, the following topics were outlined:

- Economic Reasons for Insolvency;
- Insolvency Office Holders (IOHs) and Business Management under Insolvency Procedures;
- Creditors Rights and Rules of Claim Recovery;
- Revenue Service as a Creditor;
- Disposal of Assets and Maximization of Recovered Funds.

Interviews. The interviews with core stakeholder representatives were conducted. As a result of the interviews, the project team came to the following observation: The stakeholders who have not had any experience with insolvency proceedings do not have any or very little information on the problematic aspects of the field, while the ones who have been through the process at least once (either as a creditor or as a debtor), tend to have had a very negative experience. The respondents were proactive in naming particular problems of the system, and the following topics were mentioned most frequently:

1. Principle of distribution of recovered funds among the secured creditors (absence of differentiation per ranking of the secured creditors);
2. National Bureau of Enforcement (NBE) as a Trustee, and the problematic aspects related thereto (fees, passive approach towards management, lack of responsibility or accountability towards the creditors, etc.);
3. Timeline of proceedings and delays caused by the judiciary;
4. Absence of adequate statutory rights or remedies for unsecured creditors;
5. Position of the Revenue Service (RS) in creditor rankings and the defective practices thereof, and most importantly;
6. Absence of the political will to support and implement the reform.

IRAFT. The main partners for conducting advocacy campaign were identified and the IRAFT was formed, consisting of stakeholder representatives. The representatives of the following organizations are members of IRAFT:

1. Business Association of Georgia (BAG);
2. Association of Banks of Georgia;
3. Association of Developers of Georgia;
4. Partnership Fund;
5. Georgian Co-Investment Fund;
6. American Chamber of Commerce in Georgia (AmCham);
7. Georgian Business Ombudsman;
8. Distributors Association of Georgia (DAG);
9. Georgian Small and Medium Enterprises Association (GSMEA);
10. Investors Council;
11. JSC TBC Bank;
12. Georgian Chamber of Commerce and Industry (GCCCI);
13. Association of Microfinance Organizations;
14. ALFG insolvency experts group.

The first meeting of the IRAFT was held at the BLC office in Tbilisi. During the meeting, an overview of G4G Assessment of the Insolvency System of Georgia was presented by the project manager. Subsequent discussion covered the following issues:

- Objective of the Insolvency Law;
- Rights and responsibilities of the trustee;
- Secured creditors;
- Creditor's ranking.

As an outcome of the meeting, the date and topics of the first public-private dialogue (PPD) session, as well as speakers were identified. The first PPD session was later held on June 25-26, in Crowne Plaza Hotel, Borjomi. All IRAFT members and corresponding government officials were invited to participate in the meeting. The following topics were determined to be presented by the speakers:

- Investment Environment and Economic Significance of Insolvency;
- Factors Preventing Rehabilitation;
- Protecting Unsecured Creditors' Rights in Insolvency;

- Insolvency Regime as a Tool to Overcome Crisis in the Development Business;
- Tax Issues in Insolvency;
- Secured Creditors and Transformation of Collateral in Insolvency Regime.

Advocacy Strategy. The *Advocacy Strategy* document was finalized (See Appendix 1).

The Second Milestone: Educational Activity

The purpose of the second milestone was to carry out educational activities: To develop conference/training modules and to conduct conference/training in accordance therewith, to organize discussions.

Conference. ALFG experts developed the training/conference modules. Based on developed modules, a two-day training/conference was held at Tech Park Georgia on July 14-15. The following sessions were presented to the participants -

(a) Economic Significance of Insolvency

The general objective of the session was to understand the framework of the insolvency system and its significance for economic development of the country. It also aimed to demonstrate how and through what mechanisms insolvency, which is often understood as a negative process, actually contributes to revitalization and renovation in economic processes.

During the session, the participants gained knowledge about how well functioning insolvency systems can facilitate access to finance, encourage start-up activities, save more viable businesses and play a part in sustainable growth of the economy. The session also concentrated on the investment perspective of the issue. The following topics were discussed:

- Proper insolvency system as a tool for increasing productivity;
- Stigma existing around the concept of insolvency;
- Famous companies that went bankrupt;
- Collecting debts/quick realization of all existing assets or rehabilitation of debtor – fresh start policy;
- Legislative obstacles in the way to rehabilitation or reallocation of assets;
- Better insolvency legislation - higher recovery rate;
- Disposing of remaining assets of the debtor ;
- Access to finance – creating incentives for investors to fund rehabilitation process.

Attendants: Representatives of small and medium enterprises (SMEs), large businesses and insolvency policy makers.

(b) Managing Business under Insolvency

The general aim of the session was to learn the specifics of managing business under insolvency, as well as illustrate the practical problems caused due to the absence of clear division of powers and duties among various players/managers involved in the process.

During the session, the participants gained knowledge about mechanisms required for proper business management under the insolvency regime. The presentation also concentrated on liabilities related to mismanagement and their link to proper division of authorities, illustrating the defects of existing legislation from this standpoint. Specifically:

- Absence of clear division of powers;
- Potential liabilities of insolvency managers and absence of regulations from the effective insolvency legislation;
- Remuneration – amount, payee, calculations and particular examples;
- Fragmentation of management rights and practical dilemmas related thereto;
- Absence of any mechanisms in case of disagreement on various strategic/business aspects among the insolvency administrator(s), debtor and/or the creditor(s);
- Maintaining the bankruptcy estate – related terms;
- Rights and role of the owner;
- European Bank for Reconstruction and Development (EBRD) report and appraisal of the existing system.

Attendants: Representatives of SMEs, large businesses and insolvency administrators.

(c) Revenue Service as a Creditor

The general aim of the session was to identify specifics of the State acting as the creditor in insolvency regime, to analyze the most relevant problems and the best practices related thereto exemplifying the jurisdictions with developed economies and acknowledged insolvency system.

The session also sought to identify shortfalls of certain practices of the RS and exhibit potential consequences related to contradictory and defective statutory clauses regulating the competences and authorities of the RS. The speakers also discussed potential public policy considerations with regard to determining the ranking of the State claims. They argued that the State has more liability and interest in creating a business-oriented legislative environment, as well as encouraging the rehabilitation of insolvent enterprises. Respectively, it was suggested that public policies in crafting the insolvency regulations should be more oriented on benefiting existing businesses (including the debtor, as well as other creditors), thus emphasizing that the predominant State interest should be in the development of business, rather than collecting existing one-time receivables of the tax authorities.

The following issues were discussed:

- Problems related to untimely submission of claims and protracted tax audits;
- Time-limits for submitting the claim;
- Role of a passive creditor (in spite of the fact that the RS frequently holds amount-wise significant claim, very often it refrains from voting on a particular matter);
- Problems related to promoting the State in the ranking of creditors (it is never incentivized to vote for rehabilitation);
- Inconsistencies between the tax and insolvency laws (contradictory interpretations on administrative, as well as judicial level);
- Practice of using and sometimes abusing the right to impose injunctive measures by the tax authorities and the impediments this practice creates under insolvency regime;
- Prospect of placing the RS in four ranks and the practical problems related thereto.

Attendants: Representatives of Ministry of Finance (MoF), SMEs, large businesses and public servants.

(d) Creditors Rights and Rules of Claim Recovery

The general aim of the session was to introduce the concept of creditors' rights in the insolvency regime and to describe insolvency, as the mechanism for collective satisfaction of creditors. In addition, speakers discussed the classes/rankings of creditors and related shortcomings of existing statutory regulations (for example: Absence of any regulations on (a) certain privileged claims – salaries, torts, etc.; (b) shareholder acting as creditors, etc.). In addition to the above, the session discussed rights granted to secured and unsecured creditors, absence of legislative balance between the named two primary classes exemplifying the practical injustices that followed in application of current legislative provisions *vis-à-vis* unsecured creditors.

During the session, the participants obtained information *inter alia* on (a) insolvency, as a comparably fair mechanism for collective satisfaction of creditors; (b) the best practices for organizing the creditors ranks; and (c) the way civil relations shall be effected (rather – not transformed) in the insolvency regime.

Speakers discussed the primary issues listed below:

- Ranking of creditors and the most relevant problematic aspects thereof;
- Rules for approving the rehabilitation plan – absence of participation of all creditors in the process;
- Transformation of collateral in insolvency regime;
- Principles of distribution of proceeds;
- Access to new finances – placement of a new investor in the second rank and the classes of creditors, consent of which shall be required; new obligations necessary for rehabilitation;
- Statistics of recovery, related timelines;
- Creditors' right to control the management.

Attendants: Representatives of SMEs, financial institutions and insolvency practitioners.

(e) Disposal of Assets and Maximization of Proceeds

The general aim of the session was to identify basic problems related to realization of assets in the insolvency regime and statutory provisions, which often impede maximal satisfaction of creditors. Namely, the session concentrated on excessively burdensome, inflexible and rigid regulations. Herewith, it revealed to participants the potentially positive results of softening the regulations and securing the parties' autonomy.

Speakers concentrated on the below listed issues:

- Problematic issues related to maintaining and protecting the assets; absence of clear regulations on the party responsible;
- Necessity to sell certain types of assets immediately (e.g. products of short shelf life) and inflexibility of the law in this regard;
- Unfeasibility of asset optimization and getting rid of unnecessary costs;
- Problematic aspects related to valuation and realization of intangible assets;
- Forms of realization – particular instances, when it should be possible to bypass auction in realization of the assets;
- Transfer of remainder assets to the State.

Attendants: Representatives of NBE, SMEs, large businesses and insolvency administrators.

Public lectures. Public lectures were held at Free University of Georgia and Tech Park Georgia. The public lectures aimed to raise awareness on importance of insolvency systems for economic development and the defects of Georgian insolvency legislation. The announcement on public lectures was spread out through various websites and social media sources. The lectures were opened for all interested parties and were attended by various stakeholders from the private sector.

Third Milestone: First PPD Session

First PPD session of the project was held on June 25-26 in Crowne Plaza Hotel, Borjomi. The aim of the first PPD session was:

- a. To outline the most significant findings of Georgian Insolvency System and to reconcile the positions among key stakeholders;
- b. To voice the concerns of the business community and the parties that have suffered the most due to the defective nature of the existing system in front of the Government officials and to reveal to them that they need to prioritize Insolvency Reform in their agenda and prevent abusive application of insolvency law, which is a threat for the state economy; and
- c. To understand the Government's position on the issues presented.

The session was divided into following panels:

TOPIC	SPEAKER
Investment Environment and Economic Significance of Insolvency	<i>Co-investment Fund, Ketevan Tskhadadze Partnership Fund, Vakhtang Jorbenadze</i>
Factors Preventing Rehabilitation	<i>ALFG experts, Nana Amisulashvili and Tamta Ivanishvili</i>
Protecting Unsecured Creditors Rights in Insolvency	<i>Distributors Association of Georgia, Lasha Rizhamadze</i>
Insolvency Regime as a Tool to Overcome a Crisis in the Development Business	<i>Developers Association of Georgia, Avtandil Gegenava</i>
Tax Issues in Insolvency	<i>Business Association of Georgia, Lasha Nodia</i>
Secured Creditors and Transformation of Collateral in Insolvency Regime	<i>JSC TBC Bank, Mikheil Gogvadze</i>

Speakers for each topic were selected from the IRAFT, which, according to the strategy plan of the project, would ensure to demonstrate significance of proper insolvency framework for development of business and economy.

In the beginning of the first session, the importance of the campaign and the support by G4G and USAID was underlined. It was also mentioned that during recent years, discussion about the insolvency system was held without any result and now there is a chance within the framework of advocacy campaign to mobilize quite significant stakeholders to promote particular initiatives related to the insolvency system.

Deputy Minister of Justice, Mikheil Sarjveladze, welcomed participants and mentioned that the MoJ is ready to discuss topics within the working group and that they would promote elaboration of legislative changes. It is noteworthy that the functions and role of the NBE and whether it effectively facilitates

protection of assets and sustainability of ongoing business became a subject matter of a difference of opinions.

Chief of Economic Growth Analysis Department of Ministry of Economy and Sustainable Development (MoESD), Vakhtang Tsintsadze, mentioned the importance of insolvency framework for economic development and expressed readiness on behalf of the MoESD to arrange further discussions with the business community to identify the challenges they have regarding the insolvency system of Georgia and to improve it.

The main conclusions of the session were:

- The Georgian Law of Insolvency Proceedings is not transparent and predictable. Making the Law transparent and predictable will enable potential investors to understand how the insolvency system works and to assess the risk associated with their position as a creditor in insolvency procedures. This will promote stability in commercial relations and foster lending at lower risk premiums;
- Rights of unsecured creditors should be defended more effectively, to ensure their participation in confirmation of a rehabilitation plan or in making other decisions impacting their rights. All parties need to be able to anticipate how their legal rights will be affected in the case of a debtor's inability to pay, or to pay in full, what is owed to them;
- Tax claims or pending tax claims should be clearly identified in the beginning of proceedings. It gives certainty to other lenders and investors that they will not be involved in unanticipated insolvency and will not have to compete with hidden or undisclosed claims;
- Tax claims should not rank ahead of a secured creditor with respect to its security interest and it would be better if tax claims give way to even ordinary unsecured creditors or at least allow creditors to define a flexible pay schedule, to promote rehabilitation proceedings;
- A proper insolvency law will help significantly to overcome crisis in the construction field, which appeared years ago;

In order to ensure media coverage, a group of journalists were invited to the event, and in the end interviews were recorded with the project manager and participants.

Fourth milestone: Sustainment Plan for Continued Insolvency Reform

The purpose of the fourth milestone was to elaborate the *Insolvency Reform Sustainment Plan* according to the materials that resulted from the PPD sessions and IRAFT meetings.

The Insolvency Reform Sustainment Plan. An extended IRAFT meeting was carried out on August 1 at Rooms Hotel, Tbilisi. The sustainment plan for continued IRAFT members elaborated Insolvency Reform and final recommendations.

The *Insolvency Reform Sustainment Plan* was published (See Appendix 2).

Meetings. As part of the preparatory work for the second PPD session, the working group had several meetings with GoG officials and representatives of the judiciary.

A meeting with the Deputy Minister of MoESD, Nikoloz Gagua, and his team was organized to discuss the vision of the latter in implementing the reform. The project team introduced the basic problematic issues in relation to current insolvency regulation, as well as the findings and recommendations of IRAFT. On their part, the MoESD officials presented their opinions and approaches in resolving the shortcomings of existing system. As a result of the meeting, the project team was able to identify the list of issues where the approaches of MoESD coincided with the opinions of private sector representatives.

A meeting with judges working on insolvency cases was organized by ALFG, with the assistance of the Unity of Judges of Georgia. The project team intended to ascertain the problems of courts in processing insolvency cases, as well as recommendations that the judges could have in resolving the respective issues. The representatives of the judiciary emphasized that their evaluation of existing legislative framework is rather negative. According to their statements, the following matters are the most problematic: (a) Involvement of the NBE in the proceedings as a trustee since they deem public institution unfit for managing the business; (b) absence of specialized courts, which causes overloading the judges that have to work on insolvency matters and resolve other cases in parallel; (c) number of procedural aspects are not regulated and therefore, in a number of scenarios, they have to “invent” the procedures, etc.

Fifth milestone: Second PPD Session

The second PPD session was held on August 9 in Tbilisi, at Tech Park Georgia. The second PPD session was the closing event of the project. Deputy Minister of Justice, Mikheil Sarjveladze, Deputy Minister of Economy and Sustainable Development Nikoloz Gagua, G4G Chief of Party, Milo Stevanovich, representatives of USAID, representatives of the MoF, IRAFT members, insolvency experts and other interested parties attended the meeting.

The purpose of the second PPD session was to summarize the project’s activities and discuss all important findings and recommendations. It also aimed to deliver the message of necessity of the reform and recommended changes to public officials.

The PPD was divided into two parts. In the first part of event, the IRAFT members presented the following topics:

- a. Insolvency System and Investment Environment, presented by Mariam Megvinetukhutsesi and George Jugeli from the Investors Council. Speakers emphasized importance of transparency and predictability of insolvency law for investment environment.
- b. Secured Creditors Participation in Insolvency Procedures, presented by Ekaterine Egutia, from JSC TBC Bank, and Natia Chachanidze, from JSC Cartu Bank. Speakers discussed the unfair approach of existing law to the secured creditors’ rights: The collaterals like mortgage and pledge are in fact negated because all secured creditors, notwithstanding the ranking of the security right, are placed within the same rank horizontally and the claim covers entire estate.
- c. Status of Unsecured Creditors, presented by Iva Chkonia, from Distributors Association of Georgia (DAG), and Ketevan Bashinuridze, as an ALFG expert. It was mentioned that unsecured but privileged claims (claims derived from employment, tort, etc.) are not subject to special treatment within the ranking of creditors and thus, qualify as ordinary unsecured creditors, which is contradictory to modern best practices. Furthermore, the secured creditors’ claims extend to the entire bankruptcy estate (notwithstanding whether the asset in question is used as collateral). This results in subjecting the secured creditors to preferential treatment in distributing the proceeds from the sale of assets that have not been used as a security thereof.
- d. The Role of Judges in Insolvency Procedures, presented by Tamar Chuniashvili from the Panel on Civil Cases of Tbilisi City Court, mentioned that many formalistic procedures statutorily reserved for judges are overloading courts. Furthermore, unclear regulations and gaps in the law create obstacles for successful and efficient proceedings.

In the second part of the PPD session, Tamta Ivanishvili, the project expert, presented the *Insolvency Reform Sustainment Plan*, elaborated by IRAFT. The speaker explained that the plan summarized the most significant problems identified throughout the campaign and provided respective recommendations, principles and approaches to be taken into consideration in carrying out the reform. The plan also introduced particular steps for ensuring the continuity of the Project’s findings and results to ensure that the pertinent legacy remains even after finalization of the advocacy

campaign. A printed *Insolvency Reform Sustainment Plan* was distributed among the participants, ALFG members and other interested parties.

Deputy Minister of Justice, Mikheil Sarjveladze, stated that the reform had begun and the new bill is being drafted with participation of public sector representatives and private experts. As it was announced, the baseline concepts are expected to be presented for public discussions in November 2016.

The Deputy Minister of Economy and Sustainable Development, Nikoloz Gagua, confirmed that they support the reform and will be involved in understanding the role of insolvency system for country's economic growth.

Four TV channels broadcast the event and on the same day, after completion of the event, the project manager, Nana Amisulashvili was invited to Business Contact, a TV show concentrating on business news, to discuss the PPD session and the anticipated reform.

2. A SUMMARY OF THE ACTIVITY IMPLEMENTATION PROCESS, LESSONS LEARNED AND RECOMMENDATIONS

Five milestones were accomplished during the project. The following events were held:

EVENT	DATE	NUMBER OF PARTICIPANTS	MALE	FEMALE
Workshop	May 21-22, 2016	10	3	7
IRAFI meeting	June 14, 2016	14	8	6
Public Lecture	June 17, 2016	36	18	18
IRAFI Meeting	June 24, 2016	11	6	5
1 st PPD Session	June 25-26, 2016	28	20	8
Training/Conference	July 14, 2016	40	18	22
Training/Conference	July 15, 2016	28	12	16
Meeting with Nikoloz Gagua, Deputy Minister of MoESD	July 22, 2016	8	2	5
Meeting with Unity of Judges of Georgia	July 27, 2016	8	2	6
IRAFI Discussion on Insolvency Reform Sustainment Plan	August 1, 2016	40	23	17
2 nd PPD Session	August 9, 2016	46	21	25
Public Lecture	August 10, 2016	30	9	21

Workshop. During the first milestone, five trainers from the leading practitioners of the field were identified. A two-day workshop was held on May 21-22, at Rixos Hotel, Borjomi. The workshop was attended by:

- Project Team;
- ALFG Experts;
- G4G Team.

Interviews. Twenty interviews with representatives of the primary stakeholders were conducted:

AmCham

BAG

GCCI

DAG

CACCI

GSMEA
Partnership Fund
GCF
Investors Council of Georgia
Business Ombudsman of Georgia
Bank Republic
Bank CARTU
Bank of Georgia
TBC Bank
LTD ARCI
LTD DOMUS
LTD Metra Development
LTD Colliers
JSC Populi
LTD Ioli Supermarket

IRAFT. IRAFT was formed from representatives of 13 large unions of the private sector. The member organizations are:

ORGANIZATION
JSC Partnership Fund
Co-Investment Fund
Business Association of Georgia
Georgian Chamber of Commerce & Industry
Investors Council of Georgia
Distributors Association of Georgia
American Chamber of Commerce in Georgia (AmCham)
Association of Micro Financial Organizations
Banks Association of Georgia
Developers Association of Georgia
Business Ombudsman of Georgia
Georgian Association of Small and Medium Enterprises
ALFG Insolvency Experts Group

The first IRAFT meeting was held on June 14 at the BLC office, Tbilisi.

Advocacy Strategy. The advocacy strategy document was elaborated (see Appendix 1).

Modules. During second milestone, eight leading ALFG experts were identified for development of training/conference modules:

Nana Amisulashvili	<i>Law Firm VBAT</i>
Tamta Ivanishvili	<i>BLC Law Office</i>
Giga Batlidze	<i>BLC Law Office</i>
Unana Gogokhia	<i>BGI Legal</i>
Ketti Kvartskhava	<i>BLC Law Office</i>

Ketti Beradze	<i>BLC Law Office</i>
Lasha Nodia	<i>Law firm Nodia, Urumashvili and Partners</i>
Sandro Bibilashvili	<i>BGI Legal</i>

Training/Conference. On July 14-15, a two-day training/conference was carried out at Techno Park Georgia. The following topics were presented to the participants:

- a. Economic Significance of Insolvency;
- b. Managing Business under Insolvency;
- c. Revenue Service as a Creditor;
- d. Creditors Rights and Rules of Claim Recovery;
- e. Disposal of Assets and Maximization of Proceeds.

Public lectures. During the project, two public lectures were held at Free University of Georgia and Tech Park Georgia. The announcement on public lectures was spread out through the www.alfg.ge website and various social media sources.

First PPD. The first PPD session of the project was held on June 25-26 in Crowne Plaza Hotel, Borjomi. Members of the IRAFT and representatives of the public sector attended the meeting. The speakers presented the following topics:

- a. Investment Environment and Economic Significance of Insolvency;
- b. Protecting Unsecured Creditors Rights in Insolvency;
- c. Insolvency Regime as a Tool to Overcome a Crisis in the Development Business;
- d. Tax Issues in Insolvency;
- e. Secured Creditors and Transformation of Collateral in Insolvency Regime.

Insolvency Reform Sustainment Plan. An extended IRAFT meeting was held on August 1 at Rooms Hotel, Tbilisi. Drafting the *Insolvency Reform Sustainment Plan* was the main topic of the meeting. An edited version of *Insolvency Reform Sustainment Plan* was designed (see Appendix 2) and 200 copies were published in two languages – English and Georgian. The *Plan* was distributed among stakeholders.

Meetings. On July 22, 2016, meeting with Deputy Minister of the MoESD, Nikoloz Gagua, and his team was organized to discuss the vision of this Ministry in implementing the reform. On July 27, a meeting with judges working on insolvency cases was organized with the assistance of the Unity of Judges of Georgia.

Second PPD. The second PPD session was held on August 9 in Tbilisi, at Tech Park Georgia. The PPD session was the closing event of the project. Deputy Minister of Justice, Mikheil Sarjveladze, Deputy Minister of Economy and Sustainable Development, Nikoloz Gagua, G4G Chief of Party, Milo Stevanovich, representatives of USAID, representatives of MoF, IRAFT members, insolvency experts and other interested parties attended the meeting.

The following TV channels broadcasted the event:

1. *Imedi TV*;
2. *Rustavi 2*;

3. *Public Broadcaster;*

4. *TV Pirveli.*

The project manager, Nana Amisulashvili, was invited to Business Contact, a TV show concentrating on business news, to discuss the PPD session and anticipated reform.

All above-mentioned events were advertised in social media.

All activities were conducted according elaborated plan. No specific obstacles were identified during project implementation.

3. DESCRIPTION OF PROJECT IMPACT AND RESULTS (BASED ON THE INDICATORS PRESENTED IN THE APPLICATION AS WELL AS ANY OTHER ANECDOTAL INFORMATION, STAKEHOLDER OR OBSERVER COMMENTARY)

As a result of the interviews, the project team came to the following observation: the stakeholders who have not had any experience with insolvency proceedings do not have any or very little information on the problematic aspects of the field, while the ones who have been through the process at least once (either as a creditor or as a debtor) tend to have very negative experience. Where the respondents were proactive in naming the particular problems of the system, the following topics were mentioned the most:

1. Principle of distribution of recovered funds among the secured creditors (absence of differentiation per ranking of the secured creditors);
2. NBE as a trustee and the problematic aspects related thereto (fees, passive approach towards management, lack of responsibility or accountability towards the creditors, etc.);
3. Timeline of proceedings and delays caused by judiciary;
4. Absence of adequate statutory rights or remedies for unsecured creditors;
5. Position of the RS in creditor rankings and the defective practices thereof;
6. Absence of the political will to support and in fact implement the reform.

During the interviews with the stakeholders and the discussions with the insolvency practitioners, the project team came across a number of interesting and unusual cases or dilemmas faced by various actors due to the defective and incomplete nature of the current legal framework. To name a few: Sale of deposits for the 50% of its value at an auction, waste of company resources due to the fact that it is impossible to dispose of the company assets at the initial stage of insolvency regime, etc.

The campaign was carried out in close cooperation with the private sector and as a result, IRAFT was formed. The following organizations were represented in the group: JSC Partnership Fund, Georgian Distributors Association, BAG, Co-Investment Fund, Business Ombudsman, Georgian Association of Small and Medium Enterprises, Georgian Chamber of Commerce, Investors' Council, Georgian Banks' Association, American Chamber of Commerce, Georgian Developers Association, ALFG Insolvency Experts Group. The working group was created as a platform for discussions under ALFG, which will be prepared to state its position on particular legislative initiatives quickly, efficiently and with required qualifications or be otherwise involved in the reform.

The working group has elaborated the reform action plan. It overviews the most significant problems identified over course of the campaign and provides respective recommendations, principles and approaches to be taken into consideration in carrying out the reform.

A number of educational activities held throughout the project aimed to deliver the information/knowledge, which was otherwise concentrated in the narrow group of field professionals, to the wider public including: Students, lawyers and economists, insolvency practitioners, business community, etc. The speakers also intended to bring the preliminary opinions elaborated within the IRAFT to discuss with the wider public and "test" how the respective approaches would be perceived by "lame" practitioners (who have not dealt with these matters before), as well as those having experience in this regard (judges, lawyers/managers involved in certain insolvency cases). One of the primary results of the educational activities was to raise awareness on the insolvency system itself, the importance of using the system where it is necessary and the importance of effective reform of

insolvency system to the Georgian economy. All interested parties became acquainted with the assessment of various international organizations (G4G, EBRD, etc.).

The PPD sessions served to outline the most significant findings of the Georgian Insolvency System, to reconcile the positions among key stakeholders, to voice the concerns of the business community and the parties that have suffered the most due to the defective nature of the existing system in front of Government officials and to influence them to prioritize insolvency reform in their agenda. The sessions also served to prevent abusive application of insolvency law, a threat for the state economy; and to understand the Government's position on the various issues presented. As a result of the PPD sessions, the project team was able to identify issues where the position of the public and private sectors coincide (the fate of remained assets, strengthening of unsecured creditors role, maintaining the right of secured creditors, etc.) and issues which still remain controversial (ranking of state claims, who should serve as a trustee, standard of commencement of insolvency proceedings, etc.).

4. A DISCUSSION OF HOW GRANT FUNDING CONTRIBUTED TO THE OBJECTIVES OF THE PROGRAM

The objective of this grant was to create a formidable advocacy campaign for Insolvency Reform by making it a prioritized interest of the public. The grant funding served as a basis for project implementation. Allocated funding contributed to following activities:

- The group of insolvency experts was actively engaged in:
 - Planning of the advocacy campaign;
 - Development of advocacy strategy;
 - Elaborating of the modules for training/conference;
 - Elaborating Insolvency Reform Sustainment Plan;
- The following activities served as awareness raising events through involving wider public in the process:
 - The interviews with the representatives of the core stakeholders were conducted to gain support for reform campaign and forming working group IRAFT;
 - Public lectures held aimed to raise awareness on importance of insolvency systems for economic development and the defects of Georgian insolvency legislation;
 - ALFG experts developed training/conference modules. Based on developed modules, a two-day training/conference was held on five different topics. ALFG participated in elaborating Insolvency Reform Sustainment Plan.
- IRAFT was created to support reforms and serve as primary platform for discussions problematic issues of insolvency system and applicable recommendations.
- Two PPD sessions were held with the participation of MoJ, MoESD, MoF, NBE, private sector, insolvency experts and media. As a result of the PPD sessions:
 - The project team was able to identify the issues where the position of public and private sectors coincides and issues which still remain controversial;
 - Insolvency reform was promoted in the political agenda. In particular: Deputy Minister of Justice Mikheil Sarjveladze stated that they would accelerate working on the new law in the GIZ working group, which is currently working on the legislative concepts; MoESD intensified involvement in the reform, which is demonstrated, amongst others, with engaging wider group of its specialists in the GIZ working group.
- As a guide to future reform, IRAFT and ALFG experts group drafted the *Insolvency Reform Sustainment Plan*.

APPENDIX A:

INSOLVENCY REFORM ADVOCACY STRATEGY

1. EXECUTIVE SUMMARY

The purpose of the *Insolvency Reform Advocacy Strategy* is to identify the basic areas of concern among the legal practitioners and stakeholders involved with insolvency proceedings, and convert the identified concerns into the reform's initiative. Therefore, a predominant part of executing the strategy will include raising awareness among target groups and demonstrate the necessity of imminent changes. Efforts will be taken to attract all interested parts and engage effectively government in public-private dialogue (PPD).

To build a strong and unified voice in PPD, alliances between all interested groups will be built and IRAFT (Insolvency Reform Advocacy Task Force) will be created, which will seek to involve as many interested parties as possible. The purpose of IRAFT's work will be to outline the problematic aspects of current insolvency regulations and practice and work on elaborating the best possible solutions for the issues in question.

2. BACKGROUND

Georgia's insolvency system has become a prolonged challenge for all participants involved with insolvency proceedings. The *Insolvency Reform Advocacy Strategy*, a G4G grant program, was initiated due to the need to foster and encourage insolvency reform and adopt an effective insolvency regime.

During the last few years, discussion about the insolvency system was held within various groups of interested parties/organizations. There were several initiatives from public and private groups to amend the law or part of existing regulations, yet no results came to fruition.

This platform will seek to mobilize relevant stakeholders to promote and advocate particular initiatives related to the insolvency system and to involve government in PPD within the framework of the advocacy campaign.

3. METHODOLOGY

For influencing the policy and carrying out campaign, the following activities are envisaged:

- Build alliances and forming strong partnership.

For this purpose, it is essential to analyze possible partners and the type of contribution they can provide: Whether they have political influence, do they have access to decision makers or can people from these entities participate in the campaign as public speakers or trainers. In addition, one of the

objectives is to find out whether stakeholders have any expertise and/or experience participating in insolvency proceedings.

Table 1: Potential Partner Analysis

POTENTIAL PARTNER	CONTRIBUTIONS
Partnership Fund	Access to decision makers
Georgian Co-Investment Fund	Access to decision makers
Business Association of Georgia (BAG)	Access to decision makers, human resources ¹
Georgian Small & Medium Enterprises Association	Access to decision makers, human resources
Georgian Chamber of Commerce & Industry	Access to decision makers, human resources
Investors Council of Georgia	Access to decision makers, human resources
Distributors Association of Georgia	Access to decision makers, human resources
American Chamber of Commerce in Georgia (AmCham)	Access to decision makers, human resources, expertise
Association of Microfinance Organizations	Expertise, human resources
Banks Association of Georgia	Access to decision makers, human resources, expertise
Developers Association of Georgia	Human resources, expertise
Unity of Judges of Georgia	Expertise
Young Entrepreneurs	Human resources
Business Ombudsman of Georgia	Access to decision makers, expertise

¹Lecturers, speakers, volunteers

- Determine primary target audiences for each objective; analyze their positions toward insolvency reform and name people/organizations to influence target audiences; schedule concrete activities for achieving objectives.

OBJECTIVE 1

To make insolvency reform a prioritized interest of the business community and public.

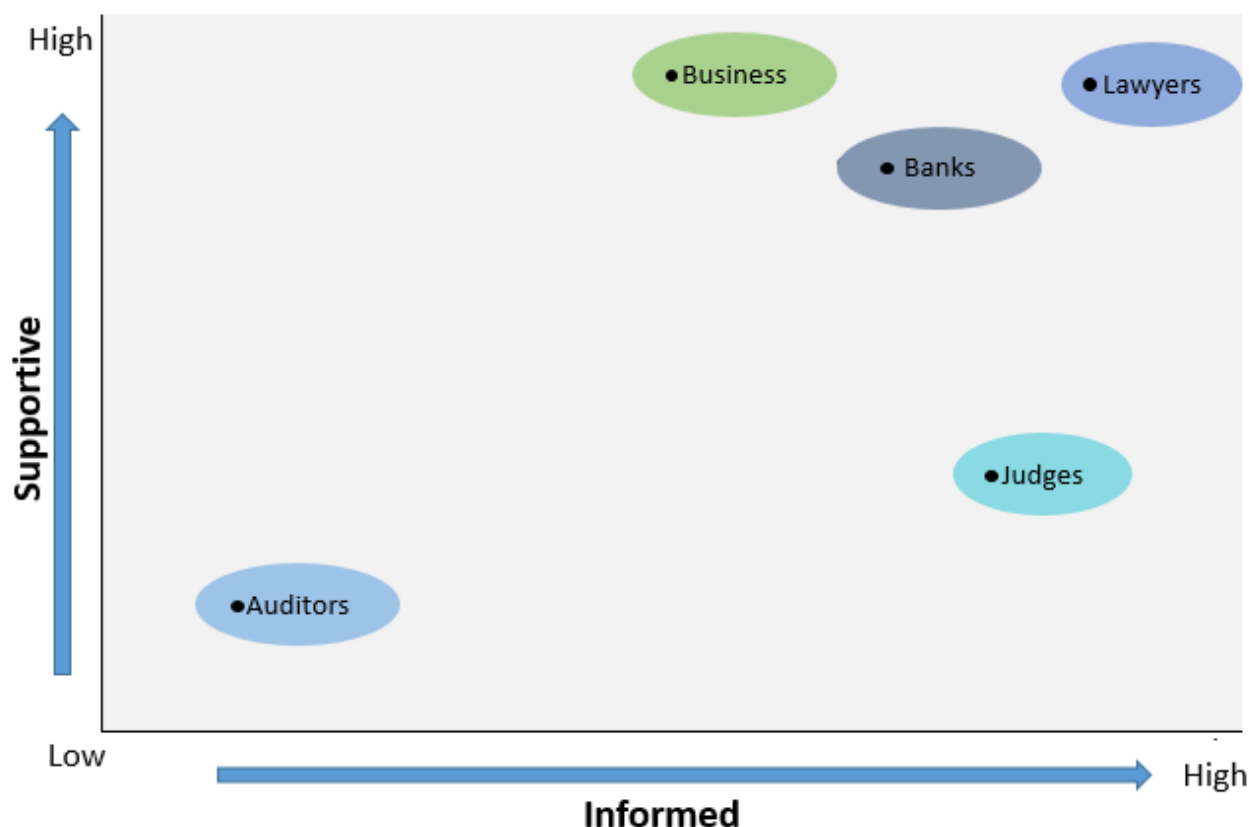
OBJECTIVE 1 TARGET

For reaching objective 1, primary targets are the main stakeholders from the private sector and judicial system:

Table 2: Target Audience Analysis

PRIMARY AUDIENCE	POSITION ON INSOLVENCY REFORM	PARTNERS FOR ADVOCACY
Business community	Supportive Uninformed	Business Association of Georgia (BAG) Georgian Small & Medium Enterprises Association (GSMEA) Distributors Association of Georgia (DAS) Developers Association of Georgia
Banks & Micro Financial organizations	Supportive Informed	Banks Association of Georgia Micro Financial Organizations
Lawyers	Supportive Informed	BAG AmCham
Auditors	Supportive Informed	Association of Auditors
Judges	Neutral Informed	Unity of Judges of Georgia

Chart 1: Target Audience Analysis



OBJECTIVE 1 ACTIVITIES

The following activities should be carried out to achieve objective 1:

Conduct face-to-face interviews with targeted audience. During interviews, the project team will collect information about respondents' experience, such as, if they have been involved with insolvency proceedings, what kind of problems they faced, etc. If the respondents has not been involved in a proceeding or has no knowledge of insolvency themselves, the project team will provide him/her with information about defects of the system, the need for the reform and the major findings of the *Assessment of the Insolvency System in Georgia*, prepared by G4G. The project team will explain the need for a good law by offering the respondent to put himself/herself on the place of debtor, creditor or other player (for example an investor who wants to deal with project owned by insolvent company), and explain what kind of obstacles will he/she face in each situation concentrating on the respondent's current activity.

Creation of IRAFT group from identified partners. IRAFT will be formed with stakeholders' representatives. IRAFT will serve as a mechanism for mobilization of groups in support of the reform; it should ensure creation of a common platform for target groups - especially with conflicting interests such as banks and entrepreneurs who usually face the risks associated with being an unsecured creditor during the insolvency proceedings. It is intended that IRAFT shall: (a) Be the marketplace where parties holding quite different positions and interests can share their concerns and try to understand the opponent's position, and; (b) serve as a long-term working group that will enable the project team to mobilize significant stakeholders in case of the need to promote or lobby particular initiatives related to the insolvency system.

As an outcome of the first IRAFT meeting, topics of the 1st PPD session will be selected and include the most significant gaps of the current insolvency system. Herewith, respective speakers will be identified. IRAFT members will also be requested to use the resources of each organization involved, to the maximum extent possible, to advocate the reform and spread the word on the troublesome aspects of the existing system.

Hold educational public lectures on gaps of existing legislation and the necessity of reform.

The aim of the public lectures is informing the broader public/interested parties on the problems of insolvency system, open discussion on problems and need for reform. G4Gs *Assessment of the Insolvency System in Georgia* will be presented. Expected result is to raise awareness by concentrating on real-life cases, illustrating the defects of existing system and analyzing often-anecdotal consequences of existing regulations, instead of theoretical analysis of matters in question.

One public lecture will be held at the Free University of Tbilisi where the main target audience will be law students and students from business management faculties and in addition all interested people will be invited by using IRAFT member associations network and social media (Facebook, Twitter). The approximate number of people attending will be 30 persons.

Another lecture will be held at the Techno Park Georgia for mostly young entrepreneurs and startup businesses. About 30 persons will be attending the lecture.

Engage the media to promote issue and using social media for advertisement of ongoing activities and achievements. The purpose of this activity is to inform broader public/interested parties on the problems of existing system, as well as the activities carried out throughout the advocacy campaign. Very often, the mere fact of informing the public/interested audience on conducting the advocacy campaign raises awareness on the necessity of the reform. For this purpose social media sources will be used. Public lectures will be uploaded on YouTube; information on ongoing events will be shared on Facebook and Twitter.

In order to ensure participation of media, “coffee and conversation” meeting with a group of journalists will be held. Journalists will be invited on planned PPD events. This will also ensure broad coverage of the events, which we consider material for formation of the political will as the Government, allegedly, would like to seem conscious to the need of economic reforms. This may be more so during the election year.

Conduct conference. The conference “When Crisis Generates Opportunities,” will serve to mobilize broader groups of the business community, as well as public officials and experts working in the related field. Following Topics will be presented on the conference: Economic Reasons of Insolvency; Insolvency Office Holders (IOHs) and business management under insolvency procedures; creditors rights and rules of claim recovery; Revenue Service as a creditor; disposal of assets and maximization of recovered funds.

The two-day conference will be divided in five sessions. After each presentation, interactive Q&A (question/answer) sessions will be conducted. The format of the conference will enable the participants to express their concerns, find persons with similar viewpoints and understand the complexity of the related issues. Open discussion of problematic aspects shall also serve as a mechanism for finding solutions/compromises related thereto.

The target audience of the conference will be business community, public officials and experts. The expected number of attendees is approximately 50 persons.

Table 3: Activity Timetable for Achieving Objective 1

ACTIVITY	LEAD PERSON/ ORGANIZATION	TIMING
Conduct face to face interviews with target audience	Project team	05/20/2016 - 06/10/2016
Creation of IRAFT group from identified partners	Project team; Potential partner associations	05/20/2016 - 06/10/2016
Hold IRAFT meeting	Project team; Potential partner associations	06/14/2016
Hold educational Public Lectures on gaps and needs of Insolvency Reform	Tamta Ivanishvili Nana Amisulashvili	06/15/2016 - 07/01/2016
Using social media for advertisement of ongoing activities and achievements	Project team	05/20/2016 - 07/31/2016
Engage the media to promote issue	Project team; G4G	06/01/2016 - 07/31/2016
Conduct conference –When Crisis Generates Opportunities	ALFG members; IRAFT members	06/07/2016 - 06/08/2016

I. OBJECTIVE 2

To promote the need of insolvency reform to the top of the political agenda.

OBJECTIVE 2 TARGETS

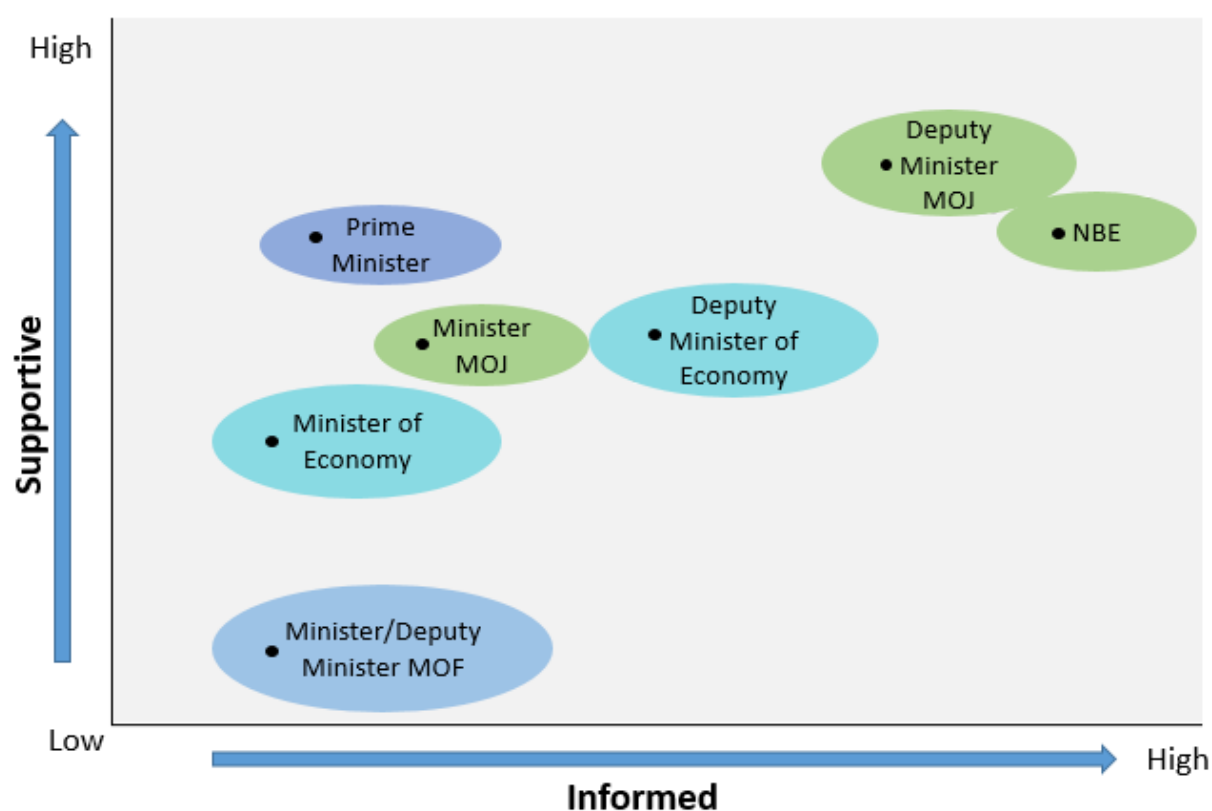
To reach objective 2, primary targets are the government officials/decision makers:

Table 4: Target Audience Analysis

PRIMARY AUDIENCE	POSITION ON INSOLVENCY ISSUE	PARTNER WITH CONNECTION	TOOLS
Prime Minister of Georgia	Supportive Uninformed	Investors Council of Georgia	To arrange meeting, make presentation on problematic issue of Georgian Insolvency System Invite to 2nd PPD Session
Minister of Justice of Georgia	Supportive Uninformed	BAG	Invite to 2nd PPD Session
Deputy Minister of Justice– Mikheil Sarjveladze	Supportive Informed		To arrange meeting; Invite to PPD Session
Minister of Economy and Sustainable Development of Georgia	Neutral Uninformed	AmCham	Invite to 2nd PPD Session
Deputy Ministers of Economy and Sustainable Development – Nikoloz Gagua	Supportive Informed		To arrange meeting, make presentation on problematic issue of Georgian Insolvency System Invite to 2nd PPD Session
Minister of Finance of Georgia	Neutral Uninformed	Business Ombudsman	Invite to 2nd PPD Session
Deputy Minister of Finance– George Tabuashvili	Neutral Informed		Invite to 2nd PPD Session

LEPL National Bureau of Enforcement Head of Insolvency Division – Natia Sakhokia	Supportive Informed	Banks Association of Georgia	Invite to 2nd PPD Session
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Chart 2: Target Audience Analysis



OBJECTIVE 2 ACTIVITIES

The following activities should be carried out to achieve objective 2:

Conduct IRAFT meetings. Three IRAFT meetings will be held to prepare PPD sessions, summarize results of the PPD sessions and to develop the recommendations for continued Insolvency Reform, etc.

Hold the first PPD session. The main purpose of the first PPD session will be to: (a) Outline the most significant findings of Georgian Insolvency System and to reconcile the positions among key stakeholders; (b) voice the concerns of business community and the parties that have suffered the most due to the defective nature of the existing system in front of the Government officials and to let them know that they need to make the insolvency reform as a priority in their agenda, and: (c)

understand the Government's position on various issues presented. The latter will also be material to categories the issues according to their sensitivity for the political establishment.

The two-day PPD session will be held in Borjomi. All IRAFT members, business sector representatives and corresponding government officials will be invited to participate in the meeting.

Journalists from two or three different publication will be invited to ensure media support. The approximate number of attendees will be 30 persons.

Conduct meetings with relevant Government officials. To identify positions/interests and to advocate the reform process, face-to-face meetings will be held with influential government officials such as ministers and deputy ministers. The project team considers that such private meetings with Government officials will be material because they may be keener to disclose certain “behind the scene” information. This will help us to better understand the context and reasoning for the State’s current policy. By knowing this, we shall be better positioned in understanding how the matters need to be advocated.

Meetings with the Deputy Minister of Justice and Deputy Minister of Economy and Sustainable Development of Georgia will be prioritized, as the leading part in the reform is MoJ, but at the same time the issue is very important for economic development of the country and the visions of the MoESD will be the determinant.

Conduct meeting with judges at the Supreme Court. As key participants of insolvency proceedings, the experience and findings of judges are of high significance. This will also enable the project team to understand the judiciary’s position on taking certain functions away from the court system. In addition, since they will be one of the primary actors in implementing the reform legislation, it is material to understand how they see the process and most importantly, how they see themselves in this process.

Conduct meeting with Prime Minister of Georgia. Present the information on problematic issues of Georgian Insolvency System underlining economic reasons for insolvency reform; discuss perspectives of the reform.

Members from IRAFT and the project team will participate in the meeting (approximately 5-7 persons).

Hold large-scale PPD session. The second PPD session will be held in Tbilisi. The main purpose of the first PPD session will be:

- To sum up the advocacy campaign, its findings and recommendations in resolving the existing controversies;
- To present IRAFT group’s members and overview of the groups work;
- To present and discuss recommendations developed by IRAFT;
- To deliver information about interviews held with stakeholders;
- To get positions from Government Officials about insolvency reform.

Up to 100 persons will take participation:

- Representatives from Prime Minister’s Office, MoJ, MoF, MoESD, National Bureau of Enforcement, Business Ombudsman’s Office;
- Donor Organizations: USAID, G4G, EBRD, World Bank, GIZ;
- Business sector representatives;

- IRAFT members;
- ALFG members;
- Representatives of Judiciary.

Journalists representing various news agencies, televisions and other media players will be invited to broadcast and spread information about the event.

Table 5: Activity Timetable for Achieving Objective 2

ACTIVITY	LEAD PERSON/ ORGANIZATION	TIMING
Hold PPD session	Project team; IRAFT members	06/25/2016 - 06/26/2016
Conduct meetings with relevant Government officials	Project team; IRAFT members	07/01/2016 - 07/26/2016
Conduct meeting with judges at Court	Project team; IRAFT members	07/01/2016 - 08/06/2016
Conduct IRAFT meetings	Project team; IRAFT members; Partner Associations	06/14/2016 - 08/06/2016
Hold large-scale PPD session	Project team; IRAFT members; Partner Associations	07/20/2016 - 08/10/2016

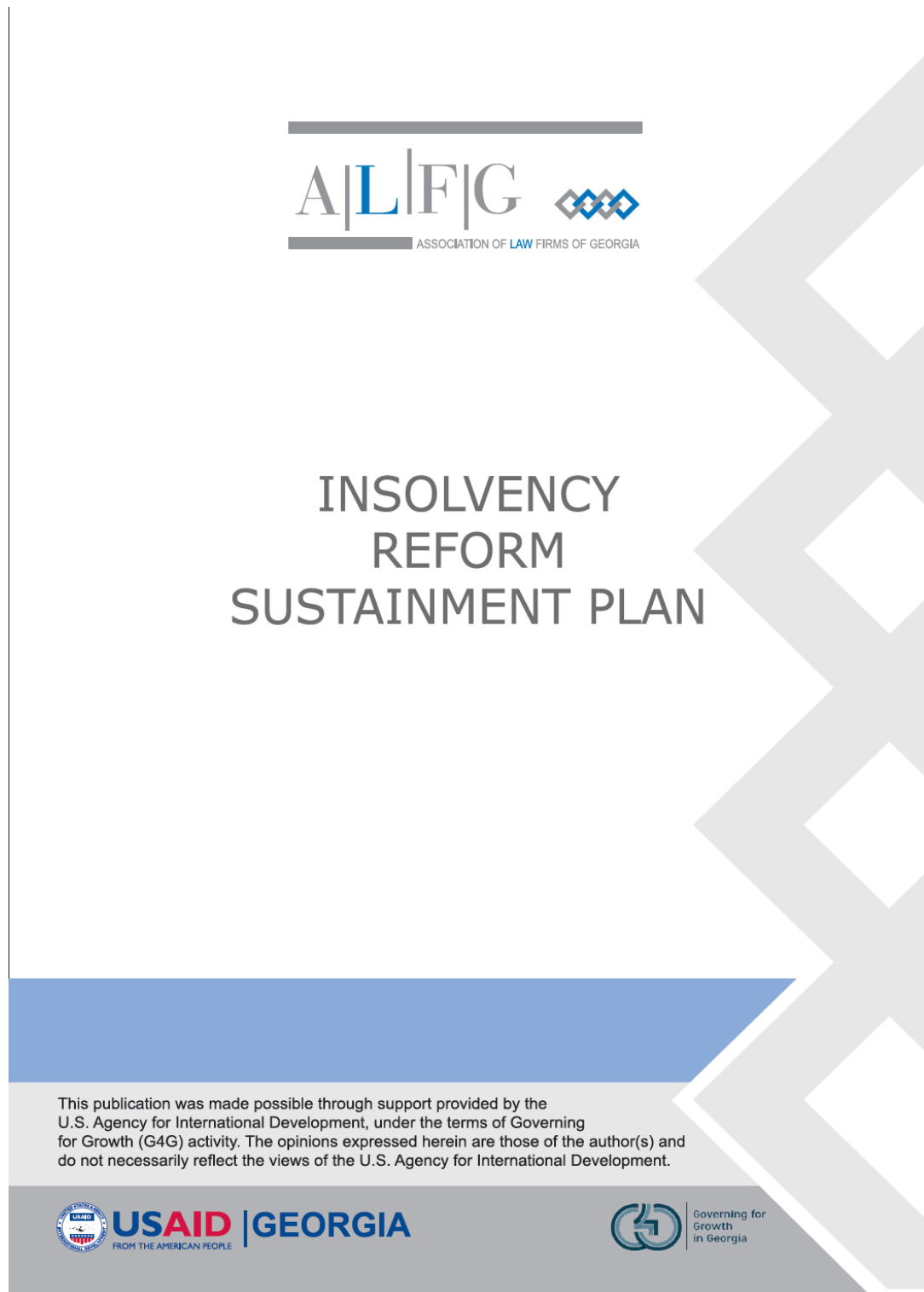
4. ADDITIONAL INFORMATION

The ALFG Insolvency Law Working Group can serve as guarantor for long-term activities, as this group is intended to continue working on insolvency issues after completion of the grant activity.

The planned long-term activities are:

ACTIVITY	LEAD PERSON/ORGANIZATION	TIMING	ESTIMATED RESULT
Creation of Insolvency Office Holders Association	ALFG	09/10/2016-10/10/2016	Create the bulk of trained professionals, who will be able to implement the respective functions
Start working on the legislative amendments based on the concept paper created during the project	ALFG	10/20/2016-03/25/2017	New Legislation

APPENDIX B:



PREVIEW

Insolvency Reform Sustainment Plan (hereinafter the plan) was created within the framework of the project – Insolvency Reform Advocacy Campaign (hereinafter the Campaign) implemented by Association of Law Firms of Georgia (ALFG) and supported by United States Agency of International Development (USAID) project Governing for Growth (G4G). The objective of Campaign was to raise awareness on existing shortcomings of current insolvency system and necessity of the reform, mobilize representatives of private sector and ensure their involvement in the private-public discussions.

The Campaign was carried out in close cooperation with the private sector and as a result, a working group was formed. The following organizations were represented in the group:

- JSC Partnership Fund
- Georgian Distributors Association
- Business Association of Georgia (BAG)
- Co-Investment Fund
- Business Ombudsman
- Georgian Association of Small and Medium Enterprises
- Georgian Chamber of Commerce
- Investors Council
- Georgian Banks Association
- American Chamber of Commerce (AmCham)
- Georgian Developers Association
- ALFG Insolvency Experts Group

The working group is the platform for discussions created under ALFG, which will be prepared to state its position on particular legislative initiatives quickly, efficiently and with required qualification or be otherwise involved in the reform.

The working group has elaborated the plan. It overviews the most significant problems identified over course of the Campaign and provides respective recommendations, principles and approaches to be taken into consideration in carrying out the reform.



THE MOST SIGNIFICANT FINDINGS IDENTIFIED DURING THE CAMPAIGN

The following primary flaws were identified during the working group meetings and events held within the framework of the project and the respective recommendations were elaborated:

COMMENCEMENT OF INSOLVENCY PROCEEDINGS.

There are several material flaws in current legislative regulations on commencement of proceedings:

a) The creditors face unreasonably high standards for commencement of the proceedings, which makes it difficult to start the process and reduces the chances for rehabilitation of the debtor and satisfaction of creditors.

RECOMMENDATION: It is advisable to ensure that the procedures for opening the proceedings are simple and easily accessible to the creditor or the debtor. In parallel, all potential system abuses shall be identified and the law shall provide for respective remedies and/or rules for imposing sanctions for abuse of right.

b) The State, acting as the creditor, enjoys comparably low standards to be satisfied for opening the proceedings, which is unfair towards other creditors.

RECOMMENDATION: The law shall provide for equitable treatment of all creditors.

c) Currently, there is a transitional period before commencement of reorganization or liquidation, which significantly impedes the process, weakens the business management and jeopardizes the asset value. This has an inevitable reflection on creditors' interests and the possibility of rehabilitating the debtor.

RECOMMENDATION: Due to the circumstance that the transitional period (trusteeship) is an obstruction, it is advisable to make reorganization or liquidation accessible without such period.



UNSECURED CREDITORS.

Several basic defects are identified in this regard: a) no unsecured but privileged claims (claims derived from employment, tort, etc.) are considered in the ranking of creditors; b) unsecured claims of the State (the tax claim) is in fifth rank, while other unsecured claims follow only afterwards in the sixth rank. Such disparity creates the sense of injustice.

RECOMMENDATION: Types of unsecured creditors shall be further scrutinized and fair ranking shall be adjusted.

CONCEPT OF SECURITY (COLLATERAL) IN INSOLVENCY REGIME.

Based on the existing law, the collaterals like mortgage and pledge are in fact negated because all secured creditors, notwithstanding the ranking of the security right, are placed within the same rank horizontally and the claim covers entire estate (not only subjects of security, but also other assets of the debtor). Such regulation, on the one hand, damages the interests of the banks that routinely use the mechanism of collateral in financing the clients and therefore, this statutory rule may become the basis for increasing the price of bank products. On the other hand, this regulation hinders execution of subordination agreements between banks and investors provided that existence of subordination arrangements does not influence statutorily pre-determined ranking.

RECOMMENDATION: The mechanism of collateral shall work in the insolvency setting in compliance with the principles and regulations of the Civil Code, meaning that the content of the right shall not be materially altered due to opening of the insolvency proceedings.

FORMS OF REALIZATION OF ESTATE.

Two basic problems are identified in this regard:

- a) the law does not provide the rules for realization of products that have short shelf life, are easily perishable or need to be sold immediately for any other objective reason; and
- b) realization of the assets is feasible only through public auction,



which, in certain scenarios, diminishes the recoverable amount and damages the interests of creditors.

RECOMMENDATION: The law shall provide for variety of mechanisms for realization of assets. In parallel, it shall contain the safeguards for ensuring that the right to choose is not abused by the process participants.

ROLE OF COURT.

According to the existing law, the court has number of formal duties, which do not contain the elements of dispute resolution. For example: organization and chairing the creditors meetings, recognition of creditors' claims, maintaining the creditors registry and granting consents to the trustee on entering certain transactions. Such duties, on the one hand, burden the court with extra routine and on the other hand, delay the proceedings.

RECOMMENDATION: The court shall be released from duties that are rather formal or related to business management.

TRUSTEE.

Based on the law (a) the administrative body - National Bureau of Enforcement is appointed as a Trustee during the transitional period; and (b) the State body participates in the business management to the extent that its consent is required for concluding any contract and managing the business is nothing but entering into variety of contracts on daily basis. Concluding contracts requires familiarity with the business and experience in business management. Respectively, statutorily, the Enforcement Bureau manages the business, which is an entirely incompatible function.

RECOMMENDATION: Management of the business shall be entrusted to an experienced business manager, while the public body may become regulator of insolvency managers' profession.

MAINTENANCE OF ASSET VALUE.

Maintenance of asset value is the primary task of insolvency proceedings because no satisfaction of creditors or reorganization of



business is feasible without it. Existence of a transitional period, where public body manages the business, significantly conduces devaluation of assets. The asset value is also influenced by the existing rules on realization of estate to the extent that it is often impossible to sell the assets on market terms due to accelerated procedures and/or the nature of the asset itself.

RECOMMENDATION: Particular attention shall be paid to maintaining the asset value through adjusting the existing regulations or incorporating additional mechanisms.

APPROVAL OF THE REORGANIZATION PLAN.

Only secured creditors approve the reorganization plan with 100% of votes. This regulation is unfair towards remainder of creditors. The reorganization consequences shall primarily concern the unsecured creditors to the degree that the secured creditors can in any case be satisfied from the subject of security.

RECOMMENDATION: The issue of approval of the reorganization plan is directly related to the problem existing in relation to preserving the security in the insolvency regime and thus, shall be solved through consistent and fair approaches. In addition to involving unsecured creditors in the process of approving the reorganization plan, the rights of secured creditors towards the subject of security shall be strengthened and protected. As regards the remaining assets, they shall be used for reorganization the debtor and/or satisfying the claims of unsecured creditors.

PRINCIPLES AND APPROACHES TO BE TAKEN INTO CONSIDERATION IN CARRYING OUT THE REFORM

It is material that Legislative Guide on Insolvency Law drafted by the United Nations Commission on International Trade Law (UNCITRAL) is duly regarded in carrying out the reform.

The purpose of the Legislative Guide on Insolvency Law is to assist the establishment of an efficient and effective legal framework to address the financial difficulty of debtors. It is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations. The advice provided in the Guide aims at achieving a



balance between the need to address the debtor's financial difficulty as quickly and efficiently as possible and the interests of the various parties directly concerned with that financial difficulty, principally creditors and other parties with a stake in the debtor's business, as well as with public policy concerns. The Guide discusses issues central to the design of an effective and efficient insolvency law, which, despite numerous differences in policy and legislative treatment, are recognized in many legal systems.

ACCORDING TO THE LEGISLATIVE GUIDE:

- ◆ In order to establish and develop an effective insolvency law, the following key objectives should be considered:
 - (a) Provide certainty in the market to promote economic stability and growth;
 - (b) Maximize value of assets;
 - (c) Strike a balance between liquidation and reorganization;
 - (d) Ensure equitable treatment of similarly situated creditors;
 - (e) Provide for timely, efficient and impartial resolution of insolvency;
 - (f) Preserve the insolvency estate to allow equitable distribution to creditors;
 - (g) Ensure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and
 - (h) Recognize existing creditors rights and establish clear rules for ranking of priority claims.
- ◆ The insolvency law should include provisions addressing both reorganization and liquidation of a debtor.
- ◆ The insolvency law should recognize rights and claims arising under law other than the insolvency law, whether domestic or foreign, except to the extent of any express limitation set forth in the insolvency law.
- ◆ The insolvency law should specify that where a security interest is effective and enforceable under law other than the insolvency law, it will be recognized in insolvency proceedings as effective and enforceable.
- ◆ The insolvency law should include a modern, harmonized and fair framework to address effectively instances of cross-border insolvency. Enactment of the UNCITRAL Model Law on Cross-Border Insolvency is recommended.



SUBSEQUENT TO FINALIZATION OF THE CAMPAIGN, ALFG PLANS TO CARRY OUT THE FOLLOWING ACTIVITIES IN SUPPORT OF THE REFORM:

- ◆ Development of future working plan for ALFG expert group. Soon after incorporation of ALFG, an expert group was created for working on the insolvency matters. The group consists of ALFG members. This expert group facilitated initiation and successful implementation of the Campaign to the degree that ALFG members constitute to the project working group and core of experts involved in the Campaign. Existence of ALFG expert group serves as a guarantee that the issues raised during the Campaign will remain in the center of attention, thus facilitating initiation of reform;
- ◆ Working group of the Campaign, as a platform for discussions, will continue to work with ALFG and be involved in the reform. Each member of the working group shall ensure participation of its organization/association in the process and statement of its respective position;
- ◆ In case of initiation of the reform conducting various trainings for raising awareness in business community will be necessary. As a result of the Campaign, it was revealed that majority of businessmen, who have never dealt with the insolvency procedures, do not have any information on the system. Absence of information may become crucial for the business provided that there will be no plan or readiness if it faces the insolvency.
- ◆ Establishment of Association of Insolvency Practitioners/Insolvency Office Holders (IOH) is envisaged as one of forthcoming activities. It is intended to unite the practitioners/IOH having knowledge on the insolvency procedures. ALFG will guarantee mobilization of Insolvency Experts in order to develop Insolvency Practitioner's/IOH's professional standards, as well as, the data of Insolvency Practitioner's/IOH's.



WORKING GROUP HAS ELABORATED A VISION ON POTENTIAL RESULTS OF A WELL-THOUGHT INSOLVENCY REFORM FOR THE STATE AND BUSINESS COMMUNITY.

RESULTS FOR THE BUSINESS COMMUNITY:

- Simplified procedures of insolvency, which may become an efficient mechanism for dealing with the crisis;
- Maintaining/maximizing the value of assets and decreasing associated costs;
- Predictable and detailed insolvency regulations will make it possible to ensure business continuity and safeguard the interests of each particular class of creditors;
- Reprganization of a viable business or quick return of assets into economy.

RESULTS FOR THE STATE:

- Improvement of investment and economic environment;
- Improving the court procedures and decreasing the work load of the courts, to the extent possible;
- Facilitating innovation and economic growth;
- Using the dormant assets for creating new enterprises;
- Assisting start-up development (through making operational assets accessible with below market prices);
- Improving the country rankings in World Bank's Doing Business reports.

SUMMARY

The foregoing document contains brief summary of the events organized as part of the Campaign, as well as the issues considered during the working group meetings on problematic areas of insolvency system and necessity of reform, as well as principles and recommendations for taking into account. Evidently, in case of initiation of the reform, the working group will be prepared to elaborate detailed proposals and introduce to wider public acceptable regulations with regard to the issues discussed herein above.



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